

Do Latvian households producing solar energy conduct business under VAT Act? 1/21/22



PwC partner and head of tax department
Ilze Rauza



PwC senior tax associate
Kristine Skrastina

As the cost of living is rising day by day, people are struggling to embrace the need to cut carbon emissions as a priority. Tax policy is one of the tools capable of affecting our decisions. So it is very important to devise a long-term tax strategy that would encourage us to change our daily habits and switch over to green energy.

The member states may even introduce a specially reduced rate of VAT (down to 0%, without restricting the supplier's right to deduct input tax) on supplies of solar panels to private homes and public buildings. A reduced rate may also be applied on supplies of electricity, district heating and cooling, and certain biogas, as well as on the supply and installation of certain very efficient low-emission heating systems. Latvia will have to stop applying a reduced rate on supplies of wood used as fuel by 1 January 2030.

This article explores some of the tax implications for people installing solar panels at their homes.

The CJEU's stance on electricity transfers to the grid

Most of the households having installed solar panels (or wind generators) for their own needs will automatically transfer electricity to the common electricity grid, rather than storing it in batteries, during periods in which more electricity is produced than what is consumed by the electrical appliances that are on in the home at that moment. The total electricity transferred to the grid can be used again later. Each country goes about setting up this scheme in a different way that may also have different tax implications.

Here's the question: Do households transferring electricity to the grid carry on a business? The Latvian State Revenue Service has yet to publish an opinion on this.

The CJEU, however, has dealt with the question of whether a person's supply of electricity to the common grid is considered a business activity for VAT purposes.

Background

In 2005, T. Fuchs installed solar panels on the roof of his home that were connected to the grid (a subsidy had helped him pay for those). Since the equipment did not have a storage facility, all the electricity produced was supplied to the grid, and the household bought back the required electricity for the same price it had been supplied. T. Fuchs consumed more electricity than he produced and supplied. T. Fuchs was registered for VAT, so the electricity transferred to the grid was subject to VAT, and he asked for a refund of the VAT he had paid on the equipment purchase. The Austrian tax authority refused a refund on the grounds that T. Fuchs was not conducting a business activity. The dispute landed in the CJEU.

The CJEU stated that any person that independently carries on a business activity at any place regardless of its purpose and outcome is considered a taxable person. The term "business activity" covers all activities of producers, sellers and service providers, including the long-term use of any tangible or

tangible property to gain income from it. The CJEU found that the use of photovoltaic equipment should be treated as one covered by the term “business activity” if it is used for a long time for the purpose of gaining income.

The CJEU made the following findings:

- The term “income” should be taken to mean a consideration that is received for an activity that has been carried out. The electricity produced by the photovoltaic equipment was supplied to the grid for a consideration, so the equipment was used for gaining income.
- The photovoltaic equipment was intended for long and permanent use, not only occasional.
- It is irrelevant whether that use is made for profit or not.
- It is irrelevant that the equipment produced less electricity than what was used for household needs (the supply of electricity and the acquisition of electricity should be treated as independent activities).

So, the conditions had been met for the term “business activity” to cover this activity and for the person to be recognised as a taxable person.

Latvian households are not conducting a business under the VAT Act

Latvia operates a different scheme for households producing electricity for their own needs from renewable energy sources. If more kWh are transferred to the grid than what is consumed, the surplus is carried forward to the following month; if more kWh are consumed than what is transferred to the grid, the kWh accrued in the previous period are used or more electricity is taken from the grid. The electricity transferred to the grid must be used within one year running from 1 April to 31 March in the following year. At the start of a new accounting year, all savings are cancelled. There is no fee to pay for electricity the household produces and consumes at once. If the household transfers electricity to the grid and uses it later, it has to pay transmission and distribution fees as well as the fixed part of the compulsory purchase component (according to capacity) but the full fee is payable for the part of electricity that is taken from the common grid in addition to the home-made electricity (for electricity, for transmission and distribution services, and for the compulsory purchase component).

Accordingly, under the Latvian model, households only store electricity and pay for transmission and distribution services, rather than selling it to the grid operator. Can households producing electricity for their own needs be treated as conducting a business in this situation? We do not find any transaction made for a consideration here. Latvian households that produce electricity using solar panels or wind generators and transfer it to the transmission operator do not carry on a business under the [VAT Act](#).